Internal Revenue Service
memorandum

CC:TL-N-2364-90
Br3:WEMcLeod

date: APR 3 1990

to: District Counsel, Louisville C:LOU

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [redacted] CC:LOU-TL-N-1528-90

This is in response to your request for tax litigation advice regarding who bears the burden of proof of establishing fiduciary liability under 26 U.S.C. § 6901(a)(1)(B) and what is the proper method of computation of the liability and the statutory accruals under that section.

Issues:

1. Whether the Service has the burden of proof of establishing fiduciary liability under section 6901(a)(1)(B).

2. How is the basic statutory notice amount of the fiduciary liability computed?

3. What, if any, statutory accruals are applicable with respect to the redetermined fiduciary lability from the date of the improper distribution?

Summary:

1. You are correct in concluding that the burden of proof of establishing fiduciary liability under section 6901(a)(1)(B) falls on the fiduciary contrary to what is stated in the manual.

2. In this case, the fiduciary's liability equals the debts owed the United States, plus interest because the value of the assets equals or exceeds the debts owed the United States.

3. Only statutory interest accrues against the fiduciary's liability from the date of the distribution to the date the fiduciary pays the Government.

Facts:

Your office received for review a statutory notice of fiduciary liability with respect to [redacted] the fiduciary for the [redacted]. Your review raised two issues that need to be resolved before you can clear the notice for issuance. In CCDM (35)4(23)8, it is stated

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"[s]ince the respondent has the burden of establishing fiduciary liability, there must be alleged in the answer, and proved at the trial, each essential element thereof." Your research failed to disclose any authority for such statement. Indeed, you located two cases where we argued that the petitioner has the burden of proof.

CCDM (35)4(23)8 also states "[i]f the value of the distributed assets is in excess of the tax, penalty, and interest due, the personal liability will be the amount of the tax and penalty, plus interest from the due date of the tax and from the date of notice and demand to the 'estate' or 'donor' for the penalty to the date of payment." You are uncertain as to the meaning of this sentence and its application to an "unlimited" liability situation.

Discussion:

Issue 1:

We agree with your legal analysis of this issue. As noted in Satnick v. Commissioner, 37 T.C.M. (CCH) 1217, 1219 (1978), the legal analysis governing fiduciary liability under 26 U.S.C. § 6901(a)(1)(B) is distinct from that of a transferee under section 6901(a)(1)(A).

The Tax Court explains this distinction in Grieb v. Commissioner, 36 T.C. 156 (1961). Transferee liability covers the situation where one takes complete title to property from an insolvent debtor without full, fair, and adequate consideration to the prejudice of the rights of the creditors of the transferor. The transfer is void against existing creditors. The rights and priorities of the Government against the transferee is determined by State law. A fiduciary is defined in the Code as a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person. Unlike a transferee, a fiduciary can be liable under section 3467 of the Revised Statutes (31 U.S.C. § 192)[1] only to the extent of debts he pays on behalf of the debtor which do not have priority over the Government. Transferee and fiduciary liability attaches to persons holding different interests in property for different purposes, and imposes different standards of liability. Id. at 161-162.

As you point out in you memorandum, in Irving Trust Co. v. Commissioner, 36 B.T.A. 146, 147-148 (1937), we argued that burden of proof regarding fiduciary liability fell on the petitioner because, unlike transferee liability, there was no

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1 Former 31 U.S.C. §§ 191 and 192 (I.R.C. §§ 3466 and 3467, Revised Statutes) were combined into 31 U.S.C. § 3713.

provision which places the burden of proof on the Government. The court did not decide this question because there was no failure of proof in this regard. The court, however, framed the issue as to whether the petitioner ever became liable under section 3467 of the Revised Statutes.

Section 3466 of the Revised Statutes gives priority to debts due to the United States over debts due to other creditors in the estate of an insolvent debtor. Section 3467 imposes personal liability upon a fiduciary who distributes the debtor's property to other creditors before satisfying the debts due the United States. In interpreting section 3467, the courts have held that in order to render a fiduciary liable, it must appear that the fiduciary is chargeable with knowledge of the debt due to the United States. And if the fiduciary has knowledge of the debt, it matters not how that knowledge was obtained. Irving Trust Co., supra at 148.

In McCourt v. Commissioner, 15 T.C. 734, 737 (1950), the petitioner argued that the Government had the burden to establish fiduciary liability which requires the Government to establish that the petitioner had knowledge at the time he distributed the assets that the indebtedness for taxes existed. The court rejected this argument stating that knowledge upon the part of the fiduciary as to the existence of the liability to the Government is not a specific requirement under sections 3466 and 3467, Revised Statutes. The court only required that the Government made a prima facie showing of the conditions laid down by these statutes. The court held that if the petitioner is exempt from the determination of fiduciary liability by reason of the fact that he was ignorant of the liability due the United States for unpaid taxes, the establishing of this lack of knowledge is a matter of defense. Relying on McCourt the court in New v. Commissioner, 48 T.C. 671, 677 (1967) stated the issue and burden of proof succinctly: "[w]e return to the only real issue which is present in this case, i.e., whether petitioner has satisfied his burden of proving (L. T. McCourt, 15 T.C. 734) that under the facts here present he was not chargeable with knowledge of the debts to the United States."[2]

The prima facie showing of fiduciary liability required by the Government is evident in Leigh v. Commissioner, 72 T.C. 1105, 1109-1111 (1979). There must be an unpaid tax which constitutes a debt. At a time when the estate had sufficient assets with which to pay this debt, there was a payment of a debt to another

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[2] See generally Satnick, supra at 1218 where the petitioner had the burden of proof on the issue of whether he received the assets as an agent of the corporation (fiduciary) rather than in his capacity as a stockholder (transferee).

within the meaning of 31 U.S.C. § 192.[3] It is the knowing disregard of the debts due to the United States that imposes liability on the fiduciary, to the extent of the value of the assets distributed after knowledge of the debt was obtained. The knowledge requirement may be satisfied by either actual knowledge of the liability or notice of such facts as would put a reasonably prudent person on inquiry as to the existence of the unpaid claim of the United States. Id. at 1110. In Leigh the court found that the petitioner's signature on the amended estate tax return showing an outstanding tax liability was prima facie evidence that the petitioner had actual knowledge of the existence of debt due to the United States within the meaning of section 192. Id. at 1111. The Government's prima facie showing does not require that we include in the statutory notice specific facts of the knowledge requirement. Furthermore, under the rationale of New, fiduciary liability need not be affirmatively pleaded in our answer.

Finally, as you point out in your memorandum, we again argued, as we did in Irving Trust Co., that the petitioner has the burden of proof on fiduciary liability in Bank of the West v. Commissioner, 93 T.C. 462, 467 (1989). This argument was unopposed by the petitioner, and from the court's reliance on its decisions in New and Leigh, it appears that the Tax Court agrees with our argument. Id. at 474-475.

Issue 2:

The proper method of computation of the liability and statutory accruals of the fiduciary is illustrated in Toy v. Commissioner, 34 B.T.A. 877 (1936). The Revised Statutes, now 31 U.S.C. Section 3713(b) (1982), impose a liability on a fiduciary equal to the sum of the debts owed to the United States when he pays debts of the estate to other creditors or distributes assets while he has notice or knowledge that the estates's obligations to the United States remain unpaid. The debts which the estate owes to the United States include interest as of the date of the distribution as well as tax incurred by the estate. Id. at 881. Debts owed to the United States by the estate also include additions to tax incurred by the insolvent debtor. Bank of the West v. Commissioner, 93 T.C. 462, 471 (1989). In Bank of the West, the executor of an estate was held liable for delinquency and failure to pay penalties incurred when it failed to timely file the estate tax return and timely pay the estate tax lability. The Court held that since the obligation to file a timely estate tax return and pay the tax were obligations of the

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[3] The opening paragraphs for statutory notices prescribed under IRM 4582.63(12) and the preliminary portions of statements to be attached to the statutory notices prescribed under IRM 4582.64(9) are sufficient to make a prima facie showing.

executor, the executor had notice of the penalties, which were debts of the estate, on the date it distributed the assets of the estate and thus was liable under 31 U.S.C. Section 3713(b) for these penalties as well as the tax and interest owed by the estate.

In summary, the basic statutory notice amount of fiduciary liability which is to be claimed in the statutory notice depends on the value of the assets in relation to the debts owed to the United States on the date the fiduciary distributes the assets. If the value of the assets improperly distributed is less than the debts owed to the United States, then the fiduciary liability to be claimed in the notice equals the amount distributed, plus interest. If the value of the assets equals or exceeds the debts owed the United States, which is the case here, the fiduciary liability equals the debts owed the United States, plus interest. So in the present case, the fiduciary liability to be claimed in the notice is the amount of tax, penalty, and interest owed to the Government on the date of distribution, plus statutory interest on the sum of these amounts from the date of distribution to the date the fiduciary pays this liability to the Government. Interest on penalties is generally due from the date of notice and demand; however, there are exceptions. See Section 6601(e) under the 1954 Code and the current Code, which has been amended to change the start date for various penalties, depending on the particular version of the Code in effect on the date of notice and demand.

CCDM (35)4(23)8 is confusing and will be rewritten. The last sentence of the section deals with the interest to be claimed on a fiduciary liability in the answer in a Tax Court proceeding. It does not state that penalties other than those which had been incurred by the estate on the date of distribution should be imposed on the fiduciary. While it is not incorrect, its wording might confuse the reader. It might be interpreted to state that penalties other than those incurred by the estate are to be imposed on the fiduciary. The sentence deals with a situation where the assets distributed were greater than the sum of the tax, penalty and interest incurred by the estate. It does not draw a distinction between interest incurred by the estate prior to the distribution and interest imposed after the distribution. It appears to have been intended to demonstrate the different start dates for interest on tax as opposed to penalties. This distinction was important because, as noted above, interest on penalties generally runs from the date of notice and demand for payment rather than the due date of the return. Interest on the tax, however, runs from the date of the return.

Issue 3:

Only interest is imposed on the fiduciary lability due to the improper distribution. This interest is imposed by Section 6601(a) from the date of the distribution to the date the fiduciary pays the Government the amount of his fiduciary liability.

Conclusion:

For the reasons discussed above, we conclude that you are correct that the burden of proof in a fiduciary liability cases falls on the fiduciary. The manual is in error on this point. We will revise the manual accordingly. We also conclude that the manual is confusing as to the proper method for computing the liability and statutory accruals of the fiduciary and will be rewritten. If you should have any further questions, please call Will E. McLeod at FTS 566-3407.

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